

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO

Criminal Case No.

UNITED STATES OF AMERICA,

Plaintiff,

v.

1. GRANT GRAHAM,
2. THOMAS HALL,
3. JOHN WALKER,
4. BRYAN TREADWAY,

Defendants.

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**INDICTMENT**

**18 U.S.C. § 371, Conspiracy**

**15 U.S.C. §§ 78m(b)(2)(A) & (B), (b)(5), 78j & 78ff(a), and  
17 C.F.R. 240.13b2-1, 240.13b2-2, 240.10b-5, Securities Fraud**

**18 U.S.C. § 1001, False Statements**

**18 U.S.C. §§ 1343 & 1346, Wire Fraud**

**18 U.S.C. § 2, Aiding and Abetting**

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The Grand Jury charges that:

**COUNT ONE**

**18 U.S.C. §371, Conspiracy**

**A. The Conspiracy**

1. Beginning on or about March 2001 and continuing until on or about January 30, 2002, in the State and District of Colorado and elsewhere, the Defendants, Grant Graham, Thomas Hall, John Walker, Bryan Treadway and others known and unknown to the Grand Jury did knowingly and willfully agree, conspire and combine to commit the offenses alleged in Counts 2-12 against the United States, namely, filing and causing to be filed a false form 10Q

with the Securities Exchange Commission (“SEC”) in violation of 15 U.S.C. §78ff(a), maintaining and causing to be maintained false books and records in violation of 15 U.S.C. §78ff, 15 U.S.C. §78m, and SEC Rule 13b2-1, making and causing to be made false statements to accountants in violation of 15 U.S.C. §78ff and SEC Rule 13b2-2, committing securities fraud in violation of 15 U.S.C. §78j and SEC Rule 10b-5, making and causing to be made false statements to the SEC in violation of 18 U.S.C. §1001 and committing wire fraud in violation of 18 U.S.C. §1343 and §1346, and did, in the course of their conspiracy, commit one or more overt acts in furtherance of such conspiracy, all as more particularly set forth below:

**B. The Defendants**

2. From on or about March 2001 through and including on or about January 30, 2002, Qwest employed Defendant Grant Graham as the Business Unit chief financial officer for the Global Business Unit of Qwest Communications International. The Global Business Unit was one of the largest business units at Qwest. Graham reported to the Chief Financial Officer of Qwest Communications International Inc. (“Qwest”).

3. From on or about March 2001 through and including on or about January 30, 2002, Qwest employed Defendant Thomas Hall as Senior Vice President in the Government and Educational Solutions group within the Global Business Unit. Hall reported to the Executive Vice President in charge of the Global Business Unit at Qwest.

4. From on or about March 2001 through and including on or about January 30, 2002, Qwest employed Defendant John Walker as a Vice President in the Government and Education Solutions group within the Global Business Unit. Walker reported to Defendant Thomas Hall.

5. From on or about April 1, 2001 through and including on or about January 30, 2002, Qwest employed Defendant Bryan Treadway as Assistant Controller.

6. From on or about March 2001 through and including on or about January 30, 2002, Qwest employed an assistant to Grant Graham (“Graham’s Assistant”) as an accountant in the finance organization in the Global Business Unit. This assistant, known to the Grand Jury, reported to Grant Graham.

### **C. Formation of the Arizona School Facilities Board (“SFB”) Conspiracy**

7. Qwest was created on or about June 30, 2000 as a result of a merger between “old Qwest” and U.S. West Inc.

8. From its inception, pursuit of quarterly revenue was a significant part of Qwest’s corporate culture. At all times relevant to this Indictment, Qwest was a publicly held company whose shares traded on the New York Stock Exchange. Qwest was the subject of numerous reports by securities analysts. Qwest was obligated to, and did, file quarterly reports with the Securities and Exchange Commission on form 10Q. These analysts' reports and 10Qs reported, among other things, Qwest’s quarterly revenue, earnings (or EBITDA), and net income. The analyst’s reports also reported on Qwest’s quarterly and annual revenue and income forecasts and rate of growth.

9. Qwest utilized stock options, commissions and corporate bonuses to attract and reward its executives, including the named Defendants. Corporate bonuses were dependent, in material part, on achievement of Qwest’s quarterly revenue and earnings targets as a whole, and on achievement of each business unit’s quarterly targets. The value of employee stock options also depended on the price of Qwest stock, and those options vested only so long as each

employee remained employed.

10. The price of Qwest's stock is, and at all relevant times was, determined by various factors including Qwest's reported revenue and income, its ability to meet revenue targets and forecasts, and its ability to demonstrate quarterly and annual revenue growth.

11. During the 2<sup>nd</sup> quarter of 2001, Qwest management established a revenue target for the Global Business Unit of approximately \$1.825 billion. As of April 13, 2001 this target was to be met through a combination of recurring revenue and an additional \$208 million in non-recurring revenue initiatives. Non-recurring revenues are revenues obtained from individual transactions that are not likely to be repeated in later quarters. Therefore, in order to meet its revenue targets each quarter, Qwest's sales teams had to find and close new transactions. The non-recurring revenue initiatives were critical to Qwest's efforts to demonstrate significant revenue growth to securities analysts. These non-recurring revenue initiatives were also material to various bonus plans in place at Qwest and to Qwest's internal management. Those bonus plans and associated employee reviews were based, in part, on whether Qwest and its various business units met their respective quarterly revenue targets.

12. During each Quarter, in July, 2001, Qwest management placed significant pressure on their subordinates to achieve their specified revenue targets. On June 20, 2001 Morgan Stanley, a leading New York investment banking firm, issued a negative report about Qwest. Thereafter, Qwest took steps to convince the investing public that Qwest stock (which then traded for approximately \$31 per share) was a sound investment.

13. By April of 2001 Defendants Graham and Hall began to discuss an impending

gap in the 2<sup>nd</sup> quarter revenue forecast for Qwest's Global Business Unit and to explore methods of filling the gap.

14. At a staff meeting in May 2001, Defendant Hall noted that Qwest was experiencing weak sales. Hall raised the question of whether Qwest could sell "CPE", or consumer premises equipment, to the Arizona School Facilities Board ("SFB") as a method of addressing this weakness.

15. In January 2001 Qwest had entered into a purchase order with the SFB to design and implement a statewide school computer network that would include Internet connectivity and a local area network for the schools. The project included evaluating the schools for telecommunications deficiencies, designing telecommunications projects for each school and school district, delivery of various items of telecommunications equipment, installation, training, technical support and maintenance. The total amount of the purchase order was not to exceed \$100 million.

16. The computer and telecommunications equipment necessary to complete this project is known as "customer premises equipment" or "CPE" because it is installed at specific sites owned and controlled by the customer. Each school site is unique and a design must be prepared for each site to determine the necessary equipment. The CPE must be installed; the customer's employees must be trained to use it; the CPE must be serviced and maintained.

17. From the beginning of the project it was agreed between Qwest and the SFB that Qwest would provide all the services necessary to install Internet connectivity for the Arizona schools, including designing the system, providing the equipment, installing the equipment, training school personnel, and maintaining the equipment. As Qwest completed the design work

for each school, SFB approved the design, and Qwest would order the necessary CPE and install it. Following the successful installation of the equipment, and only then, could Qwest recognize revenue for the sale of the equipment to the SFB according to Generally Accepted Accounting Principles (“GAAP”).

18. As required by law, GAAP sets forth the accounting rules that governed Qwest. Each Defendant knew that Qwest was required to meet the requirements of GAAP. Each year of its existence Qwest issued audited financial statements to the investing public and filed those financial statements with the Securities Exchange Commission as required by § 13 of the Securities Exchange Act of 1934, Title 15 U.S.C. § 78m. Each year, and each quarter of each year, including 2001, Qwest management represented to its auditors, to the SEC and to the investing public that these financial statements were prepared and reported in accordance with GAAP. Under applicable law, GAAP governed Qwest’s ability to recognize revenue from the SFB transaction. Under GAAP, as the agreement between Qwest and the SFB was originally structured in January, Qwest could not, and did not, recognize or report revenue on the project until the equipment was delivered to each school site and satisfactorily installed. In addition, Qwest retained the risk of loss or damage to the equipment until it was satisfactorily installed and also retained the risk that any equipment it might purchase for the project would become obsolete before it was installed.

19. Prior to June 2001 GAAP prohibited Qwest from recognizing revenue for any CPE sold by Qwest to the SFB until after the CPE was satisfactorily installed. Each of the Defendants knew of this generally accepted rule of accounting.

20. Beginning on or about the first week of June, 2001 Defendants, Graham and Hall

agreed to pursue a scheme and plan to cause the entire amount of revenue associated with the sale of CPE equipment to SFB to be improperly recognized immediately, and included in Qwest's quarterly earnings reports and SEC Form 10Q for the quarter ending June 30, 2001 in violation of GAAP, SEC Rules and Regulations and the Securities Laws of the United States.

21. Graham enlisted the assistance of his subordinate, Graham's Assistant, and Defendant Hall enlisted the support of his subordinate, John Walker.

22. Defendants Graham, Hall, Walker and Treadway knew that SFB did not need all the CPE by June 30. Each Defendant knew that Qwest had not even completed the design work for the schools. Each Defendant knew that Qwest planned to complete the project over a period of at least 8-9 months, well past the end of Qwest's second quarter. Each Defendant knew that the SFB had no reason to accelerate its order. However, Defendants schemed to utilize a type of transaction known as a "bill and hold" to provide a vehicle for immediate revenue recognition.

23. Graham, Hall, Walker and Treadway learned that the Securities and Exchange Commission, through Staff Accounting Bulletin 101 ("SAB 101"), imposed very strict requirements on a bill and hold transaction. A bill and hold transaction is one in which the seller sells equipment to a buyer, bills the customer for the equipment, and holds it at the seller's warehouse for later delivery.

24. Each Defendant knew of, and had notice of, the requirements of SAB 101. Graham's assistant and others communicated the requirements of SAB 101 to each of the Defendants, Graham, Hall, Walker and Treadway orally and in writing. Each Defendant knew that SAB 101 governed Qwest and that the requirements of SAB 101 would have to be satisfied, or else Qwest would not be able to recognize revenue for the SFB transaction in the 2<sup>nd</sup> quarter.

25. SEC Staff Accounting Bulletin 101 establishes 7 requirements for a bill and hold transaction:

1.	The risks of ownership must have passed to the buyer;
2.	The customer must have made a fixed commitment to purchase the goods, preferably in written documentation;
3.	The buyer, not the seller, must request that the transaction be on a bill and hold basis. The buyer must have a substantial business purpose for ordering the goods on a bill and hold basis;
4.	There must be a fixed schedule for delivery of the goods. The date for delivery must be reasonable and must be consistent with the buyer's business purpose ( <i>e.g.</i> , storage periods are customary in the industry);
5.	The seller must not have retained any specific performance obligations such that the earning process is not complete;
6.	The ordered goods must have been segregated from the seller's inventory and not be subject to being used to fill other orders; and
7.	The equipment [product] must be complete and ready for shipment.

26. The Defendants knew that the SFB transaction did not, and could not, meet the requirements of a bill and hold transaction under SAB 101.

27. Although the SFB transaction met none of the requirements for a bill and hold, Defendants Hall, Graham and Walker conspired to and did devise a scheme to make it appear that the transaction in fact met these requirements. Graham, Hall and Walker eventually included Bryan Treadway, the Assistant Controller, in their plan, and sought and utilized his



assistance to complete the scheme.

#### **D. The Seven Requirements of SAB 101**

28. From its inception, the scheme and conspiracy to recognize revenue encountered problems because the Defendants knew, and were repeatedly told, that virtually none of the seven requirements of SAB 101 could be satisfied by the transaction.

29. The first requirement of SAB 101 could not be satisfied. SAB 101 required the SFB to accept the risk of loss, damage or obsolescence of the equipment. SFB explicitly refused to accept the risk of loss on the CPE. When a Qwest employee, at the request of Defendants Graham, Hall and Walker, approached SFB's executive director on or about June 15, 2001, he made it clear that he would only agree to help Qwest if there was no cost or expense to SFB. The SFB Executive Director made it clear that the SFB assumed no risk for the equipment and had the right to return unused equipment. Qwest agreed to SFB's terms with the knowledge and participation of Defendants Graham, Hall and Walker. This violated SAB 101 and GAAP. In order for Qwest to acquire CPE for the project, Qwest would also be required to purchase \$35 million in equipment from Cisco. However, due to the lengthy installation schedule, and the fact that SFB would not actually be required to pay for the equipment until it was installed, Qwest faced a significant risk that much of the equipment it would purchase would become obsolete before it could be installed. This also violated SAB 101 and GAAP.

30. The second requirement of SAB 101 could not be satisfied. SAB 101 requires that the customer make a fixed commitment to purchase the goods. When a Qwest employee, at the request of Defendants Graham, Hall and Walker, approached SFB's executive director, he made it clear that the SFB would not pay for the equipment according to a fixed schedule, and

that SFB would pay only upon actual receipt, installation and acceptance of the equipment.

Qwest agreed to SFB's terms with the knowledge and participation of Defendants Graham, Hall and Walker. This violated SAB 101 and GAAP.

31. The third requirement of SAB 101 could not be met. SAB 101 required that the SFB have a substantial business purpose for the transaction. However, on or about June 14, 2001 Graham's Assistant and Walker learned that, contrary to the requirements of SAB 101, there was no immediate need for the equipment because installation was expected to take place over 6-9 months. Hall, Walker, Graham, and Treadway all knew that the equipment being sold by Qwest could be easily obtained from Cisco because it was not "long lead time" equipment. In fact, each defendant knew, as of June 23, that, in order to properly recognize revenue for the transaction, Qwest would have to obtain physical delivery of all the equipment by June 30, even though it would not be needed for months. Nevertheless, each defendant continued to take action to cause the transaction to be recorded in Qwest's books and records.

32. Even the most basic requirement of SAB 101 could not be met. SAB 101 requires that the buyer and not the seller must request that the transaction be on a bill and hold basis. In this case, the customer had never requested the bill and hold arrangement in the first place, thus violating an essential element of SAB 101. In fact, knowing the requirements of SAB 101, the Defendants schemed and conspired from the inception of the conspiracy to make it appear that the customer had requested the transaction. On or about June 11, 2001 Defendant Walker advised Defendants Hall and Graham that "once we know the requirements, then we can approach the customer with the request." On or about June 25, 2001 Defendant Treadway specifically counseled Defendant Graham as to how he could "build credibility that the customer

asked for the bill and hold without our influence.”

33. The fourth requirement of SAB 101 could not be met. There was no fixed delivery schedule for the equipment. The project involved approximately 1500 schools. As of June 30, Qwest had completed designs for only a tiny fraction of the schools. In fact, as of December 31, 2001, only a small percentage of the schools were completed. When a Qwest employee approached SFB to request its participation in the transaction, SFB made it clear that it expected the project to continue as it had in the past, with equipment being delivered as each school’s design was completed and approved. Qwest agreed to SFB’s terms with the knowledge and participation of Defendants Graham, Hall and Walker. This violated SAB 101.

34. The fifth requirement of SAB 101 could not be met. SAB 101 prohibited Qwest from retaining any specific performance obligations concerning the equipment. In fact, it was always the intent of Qwest and the SFB that Qwest would install and maintain the CPE. Qwest had already begun installing the CPE prior to June 30. SFB had made it clear to Hall, Walker, Graham, Treadway and Graham’s Assistant that it would not pay for the CPE unless and until it was satisfactorily installed. Therefore, Qwest retained significant obligations with respect to the equipment, including the obligation to install it. In addition, the SFB’s Executive Director demanded that Qwest do certain things in exchange for his cooperation, including requiring Qwest to hire a public relations firm he preferred from New Jersey. Qwest agreed to the Executive Director’s demands and terms with the knowledge of and at the direction of Defendants Graham, Hall, and Walker. This violated SAB 101 and GAAP.

35. The sixth and seventh requirements of SAB 101 could not be met. SAB 101

required that Qwest have physical custody of all the equipment from Cisco by June 30, that it hold that equipment separate from other equipment, and that it be ready to ship the equipment to the SFB. Graham, Hall, Walker and Treadway all knew that Qwest could not recognize revenue on the SFB transaction unless Cisco was able to deliver all the equipment to Qwest by June 30. By June 14, 2001, Walker, Graham, Hall, and Graham's Assistant knew that Cisco might be unable to ship the entire \$35 million called for by the SFB order by June 30. In fact, Cisco did not deliver, and Qwest did not receive, all the equipment by June 30.

36. Graham, Walker and Hall knew that the SFB transaction completely failed to meet the requirements of SAB 101. Graham, Hall and Walker knew that they would have to enlist the support of, or mislead, both the internal and external auditors for Qwest in order to book the SFB equipment sale in the 2<sup>nd</sup> quarter. At Graham's request, Graham's Assistant began to prepare a memorandum ("the Revenue Recognition Memo") to use for this purpose. On or about June 23, 2001, Qwest's assistant controller, Bryan Treadway, reviewed and commented on a draft of the Revenue Recognition Memo.

37. Treadway recognized that there were significant problems with the transaction that would preclude revenue recognition in the 2<sup>nd</sup> quarter and that Arthur Andersen, Qwest's outside auditors, would have to be satisfied before Qwest could book the revenue. In an e-mail dated June 23, 2001, Treadway set forth his concerns. Treadway's concerns were communicated to Graham's Assistant, Graham and Walker. Among other things, Treadway noted that Qwest would have to obtain \$35 million in equipment within 7 days in order to recognize the revenue, but, at the same time, would represent to its auditors that the purpose for accelerating the equipment sale was to eliminate long lead times for equipment. Treadway also warned Graham

and Walker that there were facts that someone could use to suggest that the customer had not actually requested the bill and hold arrangement and that he was concerned about the facts “hanging together.” Treadway suggested to Graham and Walker that more language be added to the Memo to “build credibility” that the customer (SFB) had asked for the bill and hold without Qwest’s influence.

38. On or about June 25, 2001 Graham instructed his Assistant and other subordinates to “get alignment” with Treadway on the issues set forth in Treadway’s e-mail.

39. Numerous overt acts, including, but not limited to those set forth in paragraphs 29-34, and 36-38 above and in paragraphs 40-48, 51, 53, 55, 58, 62, and 82 below, were committed in furtherance of the scheme and conspiracy. These overt acts in furtherance of the scheme and conspiracy included proceeding with the scheme despite the fact that it met none of the requirements of SAB 101 as set forth more specifically in paragraphs 29-34, 36-38, and 62, the creation of false documents as set forth more specifically in paragraphs 40-48, the approval of a fraudulent shipment of useless equipment as more specifically set forth in paragraphs 51, 53, and 55, the fraudulent accrual of revenue in Qwest’s books and records as set forth in paragraph 58 and the filing of a 10Q which included revenue from the SFB transaction which should not have been included as more specifically set forth in paragraph 82.

#### **E. False and Misleading Documents**

40. On or about June 11, 2001, and continuing thereafter Defendants Treadway, Graham, and Walker supervised, directed, counseled and caused the preparation of numerous materially false documents in furtherance of the scheme and conspiracy to falsely misrepresent the SFB transaction in a way that would appear to justify immediate revenue recognition.

Certain of the false documents, as more particularly described in paragraphs 41-48 below were prepared for Defendant Hall's signature, and Defendant Hall signed them knowing they were false.

41. Defendants Graham, Hall, Walker and Treadway caused five (5) materially false documents to be prepared, as described in paragraphs 41-48, in furtherance of the scheme and conspiracy to facilitate the misrepresentation of the SFB equipment sale. These documents were the June 27 Letter, the June 29 Letter, the July 2 Letter, the July 11 Letter and the June 28 Revenue Recognition Memorandum.

42. A letter dated June 27, 2001 was prepared in furtherance of the scheme and conspiracy under the direction, participation and supervision of Treadway, Graham, and Walker for Hall to sign ("The June 27 Letter"). The June 27 Letter falsely stated that SFB was requesting that Qwest "permit the state to purchase" the equipment. The letter falsely made it appear that SFB had initiated the letter. The letter also falsely stated that SFB wanted the equipment purchase accelerated to avoid long lead times and delays in installation. The letter was falsely dated June 27 to make it appear that SFB had requested the transaction, when in fact it was signed on June 29 along with the fraudulent June 29 Letter.

43. A letter dated June 29, 2001 was prepared in furtherance of the scheme and conspiracy under the direction, participation and supervision of Treadway, Graham, and Walker to be addressed to SFB and signed by Hall ("The June 29 Letter"). The June 29 Letter falsely stated that it was being written in response to the June 27 Letter, when in fact it was drafted at the same time as the June 27 Letter and had, in fact, been part of a single letter until Treadway suggested that two letters would help make it appear that SFB had requested the transaction. The

letter falsely thanked SFB for its "request" that the equipment sale be accelerated. The letter included numerous terms that were false. The letter falsely stated that SFB would pay for the equipment according to a specific schedule when in fact SFB had made it clear that it would pay according to that schedule only if the equipment was installed in the schools by those dates.

44. A letter dated July 2, 2001 was prepared in furtherance of the scheme and conspiracy under the direction, participation and supervision of Treadway and Graham for SFB to sign and send to Hall ("The July 2 Letter"). The July 2 Letter acknowledged receipt and acceptance of the equipment. The July 2 Letter also recited that either party could decide not to proceed with the remainder of the project. In fact, Qwest had not received the equipment, and SFB had not inspected or verified its receipt. In addition, SFB did not accept the risk of loss associated with the equipment and had deleted any reference to SFB accepting risk of loss from earlier versions of the letter. Finally, both parties expected and intended that Qwest would perform additional services with respect to the equipment. Qwest had already begun to furnish those additional services.

45. A letter dated July 11, 2001 was prepared in furtherance of the scheme and conspiracy under the direction, participation and supervision of Treadway and Graham, for Hall to sign and send to SFB ("The July 11 Letter"). The July 11 Letter stated that Qwest would be responsible for the equipment until it was installed, "if" Qwest was selected to install the equipment. In fact, Qwest had already been selected to install the equipment, and had begun to install the equipment and the parties expected and intended that Qwest would install it.

46. A Revenue Recognition Memo was prepared in furtherance of the scheme and

conspiracy, dated June 28, 2001, and provided to Qwest's auditor, Arthur Andersen ("The Revenue Recognition Memo"). The Revenue Recognition Memo was prepared by Graham's Assistant, revised by Treadway, and reviewed and approved by Graham and Walker. It falsely stated, among other things, that: (1) the phases of the project were separate and distinct, (2) SFB had approached Qwest and requested that Qwest move more quickly in purchasing the equipment, (3) SFB had offered to purchase the equipment immediately, (4) the purpose of the transaction was to eliminate long lead times and facilitate faster installation of the equipment, (5) the request to purchase had been provided by the SFB to Qwest in writing, (6) the SFB had taken legal title to the equipment, (7) the SFB had accepted the risk of loss for the equipment, (8) a delivery schedule had been provided by SFB to Qwest, (9) a delivery schedule had been approved by SFB, (10) the payment terms for the equipment had been developed independently of the delivery schedule, (11) payment would be due for the equipment regardless of whether Qwest installed it, (12) the equipment was complete and ready for shipment to the SFB, (13) the equipment was segregated from Qwest's other inventory in its warehouses.

47. The five false documents, which Defendants prepared and caused to be prepared, in addition to being false, omitted to state a number of material facts that caused them to be misleading. More specifically, the five false documents failed to disclose, among other things, that (1) SFB had never initiated any request to Qwest that Qwest sell it the CPE by June 30; (2) SFB had never given Qwest a business reason for a bill and hold transaction as required by SAB 101, had never given Qwest a schedule to install the individual schools, had never approved any installation schedule and had never reviewed the schedules which purported to be on SFB letterhead and which were attached to the Revenue Recognition memo; (3) SFB had never



agreed to accept the risk of loss on the CPE as required by SAB 101 and, in fact, SFB had removed language specifying that SFB would accept the risk of loss from drafts of the false letters; (4) SFB had never agreed to pay for the CPE according to a fixed payment schedule as required by SAB 101. In fact, SFB had inserted innocuous language in the June 29 letter that was intended to give the SFB the ability to pay only upon installation and acceptance of the equipment; (5) SFB had explicitly refused to accept title to the CPE as required by SAB 101; (6) SFB had not inspected or accepted the CPE as of June 30, because the CPE had not even been delivered by June 30; (7) The CPE was not delivered to Qwest's warehouse by June 30 and Qwest ordered other equipment that was not part of the CPE order to make it appear that the equipment had been shipped;. (8) There was no substantial business reason for the SFB to purchase \$35 million worth of CPE by June 30; (9) Qwest was already installing CPE in Arizona; and (10) The Defendants knew that Qwest would continue to, and had agreed to, install all the CPE.

48. Treadway provided the five false and misleading documents to Qwest's outside auditors in furtherance of the conspiracy, with the approval of Graham and Walker and with Hall's knowledge. Graham, Walker, Hall and Treadway knew that the five documents were false and that they were misleading because they failed to disclose the material information described in paragraph 47 above. The auditors relied on the five false documents in performing their work, including their 2<sup>nd</sup> quarter review of Qwest's 10Q.

#### **F. The Fraudulent Shipment**

49. In order for Qwest to recognize revenue on the SFB equipment sale in the 2<sup>nd</sup> quarter, SAB 101 required that the CPE be received by Qwest and stored and segregated in its

warehouse by the end of the quarter. Since Qwest's 2<sup>nd</sup> quarter ended on June 30, all the CPE had to be delivered to Qwest by Cisco by June 30. Cisco is a manufacturer of CPE and was the intended supplier of the CPE for the SFB.

50. On or about June 14, 2001 Defendants Hall, Graham and Walker knew that it was uncertain as to whether Cisco would be able to deliver the necessary CPE by June 30. Defendants knew that recognizing revenue on CPE that was not, and could not be, delivered was improper and violated SAB 101.

51. Nevertheless, Walker, Hall and Graham agreed that that they would continue with the scheme regardless of whether Qwest could obtain the CPE from Cisco to deliver. On or about June 14, defendant Walker sent an e-mail to Defendants Hall, and Graham stating that SFB should be asked to take title to equipment "regardless of whether Cisco has enough inventory to fill the order."

52. On June 29, 2001, Defendant Hall became aware that Cisco could not ship the necessary CPE by June 30. Instead, Cisco advised Qwest that it could ship only \$17 million by the end of the quarter. Hall knew that the failure to deliver the CPE would mean that Qwest could not properly recognize revenue on the sale to SFB.

53. Rather than recognize revenue only on the CPE that could be shipped, Hall, in furtherance of the scheme that had been previously agreed upon and with the knowledge and approval of Graham, instructed his subordinates to work with Cisco to place a supplemental order to fill the gap for whatever equipment Cisco had on hand ("the Fraudulent Order"). The purpose of the Fraudulent Order was to make it appear that Qwest was in possession of the full amount of the CPE that Qwest was selling to SFB. Hall knew that placing this Fraudulent Order

to further immediate revenue recognition on the SFB transaction violated SAB 101, GAAP, Qwest's revenue recognition policies and the Securities laws. He knew that placing the Fraudulent Order was improper. Hall placed the Fraudulent Order in order to make it falsely appear that Qwest had taken delivery of the requisite amount of equipment.

54. The equipment purchased by Qwest from Cisco in the Fraudulent Order was not included in the list of equipment that SFB had agreed to purchase. The Fraudulent Order equipment was never purchased by SFB or any other person. Neither the full amount of the \$35 million in CPE, nor the Fraudulent Order equipment was ever delivered to any Qwest warehouse by June 30.

55. Qwest suffered material losses as a result of Defendants scheme and conspiracy. Cisco had been timely and regularly shipping equipment to Qwest in small shipments as it was needed to complete the project. When Defendants Hall and Graham insisted that Cisco deliver all \$35 million in equipment, and later the Fraudulent Order as well, by June 30, Qwest had insufficient facilities to store the equipment. Defendants caused Qwest to rent additional warehouses to hold the equipment. Qwest was required to keep its warehouse open Saturday, June 30, in an attempt to receive all the equipment

56. As a result of the Defendants' scheme and conspiracy to cause Qwest to falsely recognize revenue for the CPE sale to SFB, Qwest paid unnecessary overtime to employees, paid larger bonuses to the Defendants than they otherwise would have earned, and caused false financial information to be filed with the SEC and disseminated to the public. Qwest was also deprived of its right of Defendants' honest services.

57. Eventually, Qwest conducted an audit of its Arizona warehouses and learned that they contained approximately \$9 million in useless equipment, including the equipment from the Fraudulent Order. This equipment was returned to Cisco for a net loss of approximately \$6 million.

#### **G. The Fraudulent Accrual**

58. Defendants Grant Graham, Tom Hall, John Walker and Bryan Treadway caused Qwest to improperly recognize revenue totaling \$33,577,055 as of June 30, 2001 and net income totaling \$6,457,126 attributable to the SFB equipment sale. These amounts were improperly recorded in Qwest's books and records, provided to Qwest's auditors, included in press releases provided to the investing public and included in Qwest's 10Q filed with the SEC for the 2<sup>nd</sup> quarter of 2001.

59. The effect of including the amounts set forth in Paragraph 58 in Qwest's results of operations was to falsely inflate Qwest's financial performance.

60. The false and fraudulent SFB revenue materially contributed to Qwest's effort to represent to the public its progress in meeting publicly stated revenue and earnings targets.

61. The price of Qwest shares in the marketplace is determined by a number of factors including its reported revenue, EBITDA, and income. By causing Qwest to misrepresent Qwest's revenue, earnings and income for the 2<sup>nd</sup> quarter, Defendants contributed to a false financial picture that inflated the price of Qwest shares in the market place.

62. Each Defendant knew that the purpose of the conspiracy was to cause Qwest to falsely recognize millions of dollars of additional revenue for the 2<sup>nd</sup> quarter of 2001. Each Defendant knew that one or more of the seven requirements of SAB 101 was not met. Each of

the Defendants contributed to the effort to falsely recognize the SFB revenue by taking steps to effect the object of the conspiracy including falsifying documents, instructing others to take actions to consummate the conspiracy, soliciting the execution of false documents by SFB, counseling each other and their respective subordinates as to methods to be used to conceal the true nature of the SFB transaction, fraudulently ordering unwanted equipment to further conceal the failure to meet the requirements of SAB 101, and misleading auditors, investors and others by failing to disclose material facts.

63. The conspiracy was formed in the State and District of Colorado and at least one overt act in furtherance of the conspiracy described in paragraphs 1-62 above and in paragraphs 64-82 below took place, in whole or in part, in the State and District of Colorado.

64. The conspiracy and scheme described in paragraphs 1-82 began on or about March, 2001 and continued until approximately January 30, 2002, when Qwest determined that it had improperly recognized revenue on the SFB transaction and implemented adjusting journal entries for the year ending December 31, 2001. As Qwest management concluded on January 4, 2002: "The literature is very black and white, and we were in the black."

The foregoing Count One was in violation of Title 18, United States Code, Section 371.

**COUNT TWO**  
**15 U.S.C. § 78ff (a), Securities Fraud - False SEC Form 10Q**  
**18 U.S.C. § 2, Aiding and Abetting**

65. The Grand Jury realleges and incorporates by reference the allegations in Paragraphs 1-64 and further alleges that:

66. Beginning on or about March 2001, and continuing until on or about January 30, 2002, in the State and District of Colorado, and elsewhere, Defendants Grant Graham, Tom Hall,

John Walker and Bryan Treadway, aiding, abetting and counseling each other and persons known and unknown to the Grand Jury, did willfully and knowingly make and cause to be made a statement, in a report or document required to be filed with the Securities Exchange Commission pursuant to the Securities Exchange Act of 1934, which statement was false and misleading with respect to a material fact. More specifically, Defendants knowingly and willfully (1) made and caused to be made false and misleading statements concerning the amount of Qwest's gross revenue, net income and EBITDA attributable to the Arizona School Facilities Board transaction, (2) caused Qwest to include the amount of this false Arizona School Facilities Board transaction in Qwest's second quarter form 10Q for the year 2001 which was filed with the SEC and disseminated to the investing public, and (3) caused Qwest to mislead the public concerning the absence of any illegal activity occurring with respect to Qwest's quarterly financial reports.

The foregoing Count Two was in violation of Title 15, United States Code, Section 78ff(a), and Title 18 United States Code, Section 2.

**COUNT THREE**

**15 U.S.C. §§ 78m(b)(2)(A) & (B), (b)(5), and 78ff(a), 17 C.F.R. 240.13b2-1  
Securities Fraud - Maintenance of False Books and Records  
18 U.S.C. § 2, Aiding and Abetting**

67. The Grand Jury realleges and incorporates by reference the allegations in Paragraphs 1-64 and further charges that:

68. Beginning on or about March 2001, and continuing until on or about January 30, 2002, in the State and District of Colorado, and elsewhere, Defendants Grant Graham, Tom Hall, John Walker and Bryan Treadway, aiding, abetting and counseling each other and persons known and unknown to the Grand Jury did willfully and knowingly violate a rule or regulation

promulgated under the Securities Exchange Act of 1934, namely Rule 13b2-1, the violation of which is made unlawful or the observance of which is required. More specifically, Defendants willfully and knowingly violated SEC Rule 13b2-1 by directly and indirectly falsifying, and causing to be falsified, books and records of account and by causing Qwest's books and records of account to inaccurately and unfairly reflect the Arizona School Facilities Board transaction. More specifically, Defendants prepared and caused to be prepared the five false documents set forth in paragraphs 40-48, caused these documents to be placed into Qwest's files for the purpose of appearing to support the accounting for the SFB Transaction, and caused them to be delivered to Qwest's accountants. In addition, Defendants willfully and knowingly caused Qwest's internal accountants to prepare erroneous journal entries reflecting the false SFB revenue and to include the amounts of those false journal entries in Qwest's general ledger and statement of revenue, earnings and income for the 2<sup>nd</sup> quarter of 2001. Finally, Defendants knowingly failed to implement a system of internal accounting controls, and knowingly circumvented Qwest's internal accounting controls.

The foregoing Count 3 was in violation of Title 15, United States Code, Sections 78m(b)(2)(A) and (B), and (b)(5), 78ff(a), and Title 17, Code of Federal Regulations, Section 240.13b2-1, and Title 18, United States Code, Section 2.

**COUNT FOUR**  
**15 U.S.C. § 78ff(a), Title 17, C.F.R. 240.13b2-2**  
**Securities Fraud - False Statements to Accountants**  
**18 U.S.C. § 2, Aiding and Abetting**

69. The Grand Jury realleges and incorporates by reference the allegations in Paragraphs 1-64 and further charges that:

70. Beginning on or about March 2001, and continuing until on or about January 30,

2002, in the State and District of Colorado, and elsewhere, Defendants Grant Graham, Tom Hall, John Walker and Bryan Treadway did willfully and knowingly violate a rule or regulation promulgated under the Securities Exchange Act of 1934, namely Rule 13b2-2. More specifically, Defendants willfully and knowingly violated SEC Rule 13b2-2 by (1) causing an officer to, directly and indirectly, make or cause to be made, a materially false statement to an accountant in connection with an audit, examination, or the preparation of Qwest's second quarter 2001 form 10Q, and by (2) causing an officer, directly and indirectly, to omit and cause to be omitted, a material fact necessary to make a statement made to such accountant not misleading. More specifically, Defendants willfully and knowingly deceived Qwest's auditors with respect to the true facts about the SFB transaction by, among other things, (1) delivering and causing to be delivered to the auditors the five false and misleading documents described in paragraphs 40-48, (2) by causing false financial statements and schedules to be prepared and submitted to the accountants, (3) by causing Qwest's officers and directors to make false certification to the accountants in their quarterly management representation letter for the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2001 that the financial statements were prepared in accordance with GAAP, that there had been no fraud involving management, that the accounting records underlying the financial statements accurately and fairly reflected the SFB transaction, that all agreements with customers had been fully documented, and that Qwest had adopted and was fully compliant with SAB 101.



The foregoing Count 4 was in violation of Title 15, United States Code, Section 78ff(a), Title 17, Code of Federal Regulations, Section 240.13b2-2, and Title 18, United States Code, Section 2.

**COUNT FIVE**  
**15 U.S.C. § 78j, Title 17, C.F.R. 240.10b-5**  
**Securities Fraud - Manipulative and Deceptive Device**  
**18 U.S.C. § 2, Aiding and Abetting**

71. The Grand Jury realleges and incorporates by reference the allegations in Paragraphs 1-64 and further charges that:

72. Beginning on or about March 2001, and continuing until on or about January 30, 2002, in the State and District of Colorado, and elsewhere, Defendants Grant Graham, Tom Hall, John Walker and Bryan Treadway, aiding, abetting and counseling each other and persons known and unknown to the Grand Jury did willfully, directly and indirectly, by means of interstate commerce and the mails, use and employ, in connection with the purchase and sale of a security, a manipulative and deceptive device. More specifically, Defendants Graham, Hall, Walker and Treadway willfully, falsely and fraudulently deceived Qwest's auditors, the Securities and Exchange Commission, public securities' analysts, Qwest's shareholders and the investing public by contriving to recognize revenue for the sale of approximately \$33 million of consumer premises equipment to the Arizona School Facilities Board when Defendants knew that such revenue recognition was improper and knew that false and misleading documents were prepared to support such revenue recognition if questioned.

The foregoing Count Five was in violation of Title 15, United States Code, Section 78j, Title 17, Code of Federal Regulations, Section 240.10b-5, and Title 18, United States Code, Section 2.

**COUNT SIX**  
**18 U.S.C. § 1001, False Statements to the SEC**  
**18 U.S.C. § 2, Aiding and Abetting**

73. The Grand Jury realleges and incorporates by reference the allegations in Paragraphs 1-64 and further charges that:

74. Beginning on or about March 2001, and continuing until on or about January 30, 2002, in the State and District of Colorado, and elsewhere, Defendants Grant Graham, Tom Hall, John Walker and Bryan Treadway, aiding, abetting and counseling each other and persons known and unknown to the Grand Jury did, in a matter within the jurisdiction of the Securities Exchange Commission, knowingly and willfully; (1) falsify, conceal and cover up, by a trick, scheme and device, a material fact, (2) make a materially false, fictitious and fraudulent statement, and (3) make and use a false document knowing the same to contain a materially false statement. More specifically, the Defendants caused a false form 10Q to be filed with the Securities Exchange Commission for the 2<sup>nd</sup> quarter of 2001 which 10Q contained gross revenue, net income and EBITDA numbers that improperly included the SFB transaction, and which failed to disclose the existence of material illegal acts as alleged in paragraphs 1-82 above.

The foregoing Count Six was in violation of Title 18, United States Code, Sections 1001 and 2.

**COUNTS SEVEN-TWELVE**  
**18 U.S.C. §§ 1343, & 1346, Wire Fraud**  
**18 U.S.C. § 2, Aiding and Abetting**

75. The Grand Jury realleges and incorporates by reference the allegations in Paragraphs 1-64 for Counts Seven – Twelve as though fully set forth in each of those counts, and further charges that:

76. Beginning on or about March, 2001 and continuing until on or about January 30, 2002, in the State and District of Colorado, and elsewhere Defendants Grant Graham, Tom Hall, John Walker and Bryan Treadway, aiding, abetting and counseling each other and persons known and unknown to the Grand Jury, did willfully and knowingly devise and intend to devise a scheme and artifice to defraud, and to obtain money and property by means of false and fraudulent pretenses, representations and promises, and to deprive their employer Qwest of its right to their honest services, and in connection with such scheme transmitted and caused to be transmitted, by means of a wire or radio communication in interstate commerce, writings and signals for the purpose of executing such scheme and artifice. The specific wire transmissions are set forth in Paragraphs 77-82 below.

77. **Count Seven.** In connection with, and for the purpose of executing, the scheme to defraud alleged in Paragraph 76 above, Defendants Graham, Hall, Walker and Treadway, on or about June 29, 2001, transmitted and caused to be transmitted the false June 27 Letter described in paragraph 42 by fax to Denver Colorado from Arizona.

78. **Count Eight.** In connection with, and for the purpose of executing, the scheme to defraud alleged in Paragraph 76 above, Defendants Graham, Hall, Walker and Treadway, on or about June 29, 2001, transmitted and caused to be transmitted the June 29 Letter described in paragraph 43 by fax to Denver Colorado from Arizona.

79. **Count Nine.** In connection with, and for the purpose of executing, the scheme to defraud alleged in Paragraph 76 above, Defendants Graham, Hall, Walker and Treadway, on or about July 3, 2001, transmitted and caused to be transmitted the false July 2 Letter described in paragraph 44 by e-mail from Denver Colorado to Arizona.

80. **Count Ten.** In connection with, and for the purpose of executing, the scheme to defraud alleged in Paragraph 76 above, Defendants Graham, Hall, Walker and Treadway, on or about July 12, 2001, transmitted and caused to be transmitted the false July 11 Letter described in paragraph 45 by fax from Denver Colorado to Arizona.

81. **Count Eleven.** In connection with, and for the purpose of executing, the scheme to defraud alleged in Paragraph 76 above, Defendants Graham, Hall, Walker and Treadway, on or about July 6, 2001, transmitted and caused to be transmitted the false June 28 Revenue Recognition Memo described in paragraph 46 among themselves and to Qwest's outside auditors by e-mail in interstate commerce.

82. **Count Twelve.** In connection with scheme to defraud alleged in Paragraph 76 above, Defendants Graham, Hall, Walker and Treadway, on or about August 14, 2001, transmitted and caused to be transmitted on Form 10Q, using the interstate electronic filing service known as EDGAR, a report of Qwest's quarterly revenue, earnings and EBITDA which included the fraudulent revenue for the SFB Transaction.

Each of the foregoing Counts 7-12 was in violation of Title 18, United States Code,  
Sections 1343, 1346 and 2.

A True Bill this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

Grand Jury Foreperson

JOHN W. SUTHERS,  
United States Attorney

By: William J. Leone,  
First Assistant U.S. Attorney

By: William L. Taylor,  
Assistant U.S. Attorney